

FEDERAL HOUSING FINANCE BOARD



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OFFICE OF INSPECTOR GENERAL



SEMIANNUAL REPORT

*FOR THE PERIOD
April 1, 2006 – September 30, 2006*



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EDWARD KELLEY
INSPECTOR GENERAL

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EXECUTIVE SUMMARY

The mission of the Office of Inspector General (OIG) at the Federal Housing Finance Board (Finance Board) is to support the agency's overall mission and goals established by the President, the Congress, and the Finance Board, while helping to protect the agency from fraud, waste, and abuse. Consistent with OIG's strategic plan for the period, April 1, 2004 to March 31, 2009, and in accordance with the Inspector General Act of 1978, as amended (IG Act), we continue to rely on audits, investigations, and formal and informal technical assistance to accomplish our mission. OIG's strategic plan and annual audit plan are designed to support the Finance Board's strategic plan. In that regard, we have monitored Finance Board actions related to the appointment of Public Interest Directors to the boards of the twelve Federal Home Loan Banks. We also have continued evaluating the effectiveness of the examination and supervision function and the usefulness of industry reporting requirements. We addressed agency administrative policies and procedures related to financial reporting, privacy, and information technology. We remained an active member in the federal Inspector General community to facilitate our statutory mandate to participate in government-wide efforts to prevent fraud, waste, and abuse and to remain current on matters affecting the IG community as well as the Finance Board. We continued to rely heavily on contracting and assistance from other members of the Inspectors General community for resources to accomplish required audits and investigations.

We conducted audits and audit recommendation follow-up of agency program and administrative functions. These audits were conducted in accordance with generally accepted government auditing standards issued by the Government Accountability Office. Five audits were in process at the beginning of the reporting period and three audits were initiated during the period. By the end of this reporting period, OIG had completed the following four audits: 1) an audit of the quality of guidance provided to examiners, 2) an audit of the Finance Board's compliance with the privacy provisions of Section 522 of the Consolidated Appropriations Act of 2005, 3) an audit of the data integrity of the Call Reporting System, and 4) an audit of the Finance Board's compliance with the Federal Information Security Management Act for fiscal year 2006. Four audits remained in process at the end of the reporting period. They are: 1) an audit of the disposition off IT equipment, 2) an audit of the accuracy of FHFB merit pay calculations, 3) an audit of the Finance Board's Fiscal Year 2006 Financial Statements, and 4) a Limited Review of the Finance Board's implementation of OMB Circular A-123.

Our investigative activity was performed in accordance with [Quality Standards for Investigations](#) issued by the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). Investigative matters continue to be appropriately coordinated with officials in the Department of Justice, the Federal Bureau of Investigations, and other law enforcement entities. We continued to focus on resolving

investigative matters expeditiously and identifying control weaknesses that may contribute to possible fraud or abuse. During the reporting period, we received one allegation, which after

review, was referred to another Finance Board office for disposition. Consequently, no allegation remained in process at the end of the period.

We continued to maintain positive working liaisons with: 1) Finance Board officials, in efforts to identify and correct management problems and to clarify OIG authorities and responsibilities; 2) the Congress, in order to keep them appropriately informed; 3) external auditors, to facilitate timely and accurate reporting on Finance Board operations; and 4) the Inspector General community, to keep apprised of evolving issues that affect the Finance Board. Specifically, OIG continued to monitor and provide informal input, as appropriate, into management efforts to enhance the agency's procurement function, bill payment procedures, payroll function, and information technology function. We also continued to coordinate with other financial regulatory agencies and the Government Accountability Office on audits and reviews impacting the Finance Board. In addition, OIG participated in activities involving the entire Inspector General community. As part of our affiliation with the ECIE, we continued to coordinate peer reviews of ECIE members' audit operations – a mechanism for assuring quality audits by Inspectors General and began hosting the monthly meetings of the ECIE. We also responded to various inquiries involving the activities of the Inspector General community.

A handwritten signature in dark ink, appearing to read "Edward Kelley". The signature is fluid and cursive, with a long, sweeping underline that extends to the right.

Edward Kelley
Inspector General

***BACKGROUND ON THE FHLBANK SYSTEM, THE FINANCE BOARD,
AND THE OFFICE OF INSPECTOR GENERAL***

The Federal Home Loan Bank System (FHLBank System) was created in 1932 to promote home ownership and a strong home finance industry. Its network of 12 district Federal Home Loan Banks (FHLBanks) provides lending, deposit, and other services to member institutions. Originally, the FHLBank System's membership was limited to thrift institutions, whose membership was mandatory. Since the FHLBank System's inception, membership has grown to include savings and loans, savings banks, cooperative banks, and a small number of insurance companies. As of August 1989, membership was opened to commercial banks and credit unions that meet a commitment to housing finance, as defined in law. As of May 13, 2000, membership for all financial institutions in the system became voluntary.

The 12 FHLBanks borrow funds in the nation's credit markets to lend to the FHLBank System member institutions, which numbered 8,158 as of June 30, 2006. These institutions, in turn, use the funds for home mortgages, to meet savings withdrawal needs, and for other authorized purposes. As of June 30, 2006, the FHLBanks had outstanding loans (Advances) to member institutions totaling \$640 billion for these purposes. Also, through June 30, 2006 the Affordable Housing Program (AHP) of the Federal Home Loan Bank System has provided approximately \$2.7 billion to help house some of America's neediest families. As of September 30, 2006, more than 539,000 housing units were approved. Under the competitive application program, the AHP funded almost 491,000 units of which 70% were for very-low income households.

Concurrent with the Affordable Housing Program, the Federal Home Loan Bank System has increased its efforts in overall community development through its Community Investment Cash Advance (CICA) Programs including the Community Investment Program (CIP). CICA lending, not including AHP, since the inception of the program is more than \$44 billion as of December 31, 2005.

The Federal Housing Finance Board (Finance Board), with a fiscal year 2006 budget of approximately \$35.9 million and 131 employees, is the regulator of the FHLBank System. It is an independent agency established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The Finance Board's function is to ensure that FHLBanks: 1) operate in a safe and sound manner; 2) carry out their housing finance mission; and 3) remain adequately capitalized and able to raise funds in the capital markets. The Finance Board receives its operating funds from assessments levied against the 12 FHLBanks.

The Finance Board has only indirect involvement – through the 12 FHLBanks – with the FHLBank System’s member institutions. Unlike its predecessor, the Federal Home Loan Bank Board, the Finance Board neither monitors nor examines any of the individual members of the FHLBank System. The Office of Thrift Supervision, a separate federal government agency, monitors, examines, and regulates individual member institutions. The Finance Board is only responsible for annually examining the 12 FHLBanks and the Office of Finance.

As of April 1, 2006 approximately 80 percent of the Finance Board’s staff resources are dedicated, in whole or in part, to: 1) examining the safety and soundness of the 12 FHLBanks and the Office of Finance; 2) reviewing and evaluating the work of each FHLBank’s internal audit staff; 3) monitoring FHLBank System compliance with laws, regulations, policies, and procedures; 4) assessing the FHLBank System’s financial condition; 5) modeling and analyzing the implementation of financial policies; 6) maintaining and promulgating membership policies; 7) monitoring the election and appointment of FHLBank Directors; 8) collecting information on individual FHLBank policies and marketing activities; and 9) monitoring and reviewing FHLBank and members’ compliance with requirements of the Affordable Housing Program and the Community Investment Program.

The Office of Inspector General (OIG) is responsible for the conduct of audits and investigations at the Finance Board in accordance with generally accepted government auditing standards and investigative standards. OIG may also conduct audit or investigative activities at the 12 FHLBanks and other related entities when: 1) requested to do so by the Chairman; 2) necessary to obtain information on the Finance Board’s administration of its program; and 3) aimed at detecting fraud or inefficiency in the administration or operation of Finance Board programs.

AUDIT ACTIVITY

On April 19, 2004, OIG issued its Strategic Plan for the period April 1, 2004 to March 31, 2009. OIG's annual audit plan for the period April 1, 2006 to March 31, 2007, is included as an Exhibit to the five-year strategic plan. Both can be viewed at OIG's website <http://intranet.fhfb.gov/FBOffices/oig.htm>. During the semiannual reporting period April 1, 2006 through September 30, 2006, OIG completed four audits ([Table A](#) on page 9). At the conclusion of this period, OIG also had four audits in process. OIG continued to coordinate with the Government Accountability Office and the Inspector General community on audits that impact the Finance Board. Specifically, OIG's audit activities included:

COMPLETED

An audit of FHFB Data Integrity of the Call Reporting System;

An audit of the Adequacy of FHFB's Privacy and Data Protection Procedures and Policies, which includes the the privacy provisions of Section 522 of the Consolidated Appropriations Act of 2005;

An audit of the quality of guidance provided to examiners; and

An audit of the FHFB's compliance with the Federal Information Security Management Act for fiscal year 2006.

WORK-IN-PROCESS

An audit of FHFB's disposition of IT equipment;

An audit of FHFB's Merit Promotion Pool Calculations;

A limited scope review of FHFB's compliance with OMB Circular A-123; and

An audit of FHFB's financial statements for fiscal year 2006.

INVESTIGATIVE ACTIVITY

During this reporting period OIG continued to operate in full compliance with the PCIE/ECIE Quality Standards for Investigations. The number of investigative matters processed by the Office of Inspector General during this reporting period increased to three. We had no investigative matters in process at the beginning of the reporting period but did receive three allegations. Two of the allegations were closed after the preliminary investigation stage. the third matter was referred to another Finance Board office for disposition.

Table B, on page 10, contains a numerical summary of investigations, allegations, preliminary inquires, and referrals.

SUMMARY OF "SECTION 5" REPORTING REQUIREMENTS

1. Significant problems, abuses, deficiencies disclosed by management and IG's recommended corrective actions [5a(1) and (2)]

During this reporting period, the Federal Housing Finance Board (Finance Board) continued to postpone the appointment of Public Interest Directors (PIDs) to the Boards of the 12 Federal Home Loan Banks (FHLBanks). Although the Finance Board acknowledges its statutory responsibility under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), to make PID appointments, it has taken the position that there are no deadlines for when the appointments must be made. While OIG has not examined the question of explicit or implicit deadline requirements in FIRREA, it is clear that, from a governance perspective, FIRREA requires that the Boards function with both Industry and Public Interest Directors. By the end of calendar year 2006, the terms of all PIDs on FHLBank Boards throughout the FHLBank System will expire if the Finance Board does not make any PID appointments in the interim. To avoid impairing the FHLBanks' Boards' ability to operate in compliance with FIRREA and their ability to properly carry out their governance responsibilities, the Finance Board should take immediate actions to appoint qualified Public Interest Directors to the FHLBanks' Boards of Directors.

2. Previously reported significant recommendations with incomplete corrective actions [5a(3)]

None

3. Prosecution, convictions, and referrals [5a(4)]

None

4. Reports on failure to provide information or assistance [5a(5)]

None

5. List of issued audit reports [5a(6)]

See attached [Table A](#).

6. Summary of significant reports [5a(7)]
- OIG completed an audit of FHFB's compliance with the Federal Information Security Management Act and identified a continued problem with the CIO's reliance on a contractor to perform the inherently governmental duties required of the Finance Board's Information Security Officer (ISO). However, the CIO has agreed to consider alternatives to the use of a contractor to perform the ISO duties.
7. Statistical table – audits with questioned/unsupported costs [5a(8)]
- See attached [Table C](#).
8. Statistical table – audits recommending that funds be put to better use [5a(9)]
- See attached [Table D](#).
9. Summary of prior-period audits with no current management decisions [5a(10)]
- None
10. Reasons for revisions of significant management decisions [5a(11)]
- None
11. OIG disagreement with management decisions [5a(12)]
- See number 1 above.

TABLE A

**LISTING OF COMPLETED AUDITS, SURVEYS, LIMITED REVIEWS,
AND EVALUATIONS**

<u>REPORT NUMBER REPORT</u>	<u>DATE COMPLETED</u>	<u>TITLE OF</u>
06-A-01-OS	August 15, 2006	Audit of the quality of guidance provided to examiners
06-A-02-OM/ISTS	September 29, 2006	Audit of the Adequacy of FHFB's Privacy and Data Protection Procedures and Policies
06-A-03-OS/ISTS	September 29, 2006	Audit of the Data Integrity of the FHFB Call Reporting System
06-A-04-ISTS/OM	September 29, 2006	Audit of the Finance Board's compliance with the Federal Information Security Management Act for fiscal year 2006

TABLE B

SUMMARY OF INVESTIGATIONS

BEGINNING CASES**NUMBERS**

Cases Pending at the Beginning of Period:

At the Finance Board.....	0
At the Department of Justice.....	0
At other agencies.....	0

NEW CASES RECEIVED

Allegations Received During Current Period.....	3
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STATUS OF CASES (as of March 31, 2006)

Resulted in:

Allegations Pend. Completion of Prelim. Invest/Audit.....	0
Preliminary Investigation Completed- (Cases Closed).....	2
Cases Pending Completion of Full Investigation.....	0
Full Investigation Completed- (Cases Closed).....	0
Cases Scheduled for Audit/Ltd. Rev. – (Cases Closed).....	0
Cases Pending Decision by Finance Board management.....	0
Cases Pending Decision by Dept. of Justice.....	0
Cases Pending Decision by Other Agencies.....	0
Cases Referred to FHFB Management- (Cases Closed).....	1
Referred to Other Agencies- (Cases Closed).....	0

DISPOSITION

Civil.....	0
Criminal.....	0
Administrative Sanctions.....	0
Corrective Action Taken.....	0
Other (Pending/Referrals, etc.).....	0

TABLE C

**INSPECTOR GENERAL REPORTS
WITH QUESTIONED/UNSUPPORTED COSTS**

		<u>DOLLAR VALUE</u>	
	<u>NUMBER OF REPORTS</u>	<u>QUESTIONED COSTS</u>	<u>UNSUPPORTED COSTS</u>
a. For which no management decision has been made by the commencement of the reporting period.....	0	0	0
b. Which were issued during the reporting period.....	0	0	0
Subtotals (a+b).....	0	0	0
c. For which a management decision was made during the reporting period.....	0	0	0
(i) dollar value of disallowed costs..	0	0	0
(ii) dollar value of costs not disallowed.....	0	0	0
d. For which no management decision has been made by the end of the reporting period.....	0	0	0
e. Report for which no management decision was made within six months of issuance.....	0	0	0

Note: Boldface type entries reflect actual statutory language.

INSPECTOR GENERAL REPORTS
RECOMMENDING THAT FUNDS BE PUT TO BETTER USE

TABLE D

	<u>NUMBER OF REPORTS</u>	<u>DOLLAR VALUE</u>
a. For which no management decision has been made by the commencement of the reporting period.....	0	0
b. Which were issued during the reporting period.....	0	0
Subtotals (a+b).....	0	0
c. For which a management decision was made during the reporting period.....	0	0
(i) dollar value of recommendations that was agreed to by management.....	0	0
- based upon proposed management action....	0	0
- based upon proposed legislation action.....	0	0
(ii) dollar value of recommendations that were not agreed to by management.....	0	0
d. For which no management decision has been made by the end of the reporting period.....	0	0
e. Reports for which no management decision was made within six months of issuance.....	0	0

Note: Boldface entries reflect actual statutory language.